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Facsimile Communication

DATE: May 11, 2005

TO: Mike Couick 803/212-6606

FROM: James E. Brogdon, Jr., Senior Vice President and General Counsel
Phone: 843/761-7007
Fax Number: 843/761-7037

SENDING: 8 Pages (including cover)

Attached is the information from S&P that you requested.

Jim

JEBjr:kays

Attachments



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Nikas, Dimitri

From: guerry@screentight.com
 Sent: Tuesday, April 19, 2005 10:12 PM
 To: david_bodek@sandp.com; suzanne_smith@sandp.com; dimitri_nikas@sandp.com
 Cc: guerry@screentight.com
 Subject: [Fwd: Analysis of Impact of Senate 573]



Sen 573
 Analysis.pdf

Dear David, Suzanne, & Dimitri,

Thank you for taking time to meet with me last week at Wampee. I appreciate your perspective and feel as though our conversation enhanced my understanding of your role at Santee Cooper. I feel I am obligated to update you on the pending legislative matters regarding Santee Cooper. The Senate passed a bill this morning that I believe if it becomes law will fundamentally change the Santee Cooper Board's responsibilities and obligations. The bill in my opinion is worse than we described last Tuesday. As chairman, I will be forced to shift my allegiance from the citizens of the state to the customers (most notably the electric co-ops). Please note that in a few short years Santee Cooper will begin the process of renegotiating our contract with Central. With the change of emphasis from the shareholder to the customer, the co-ops will have enough leverage to literally write their own contract. We have relayed a message to key Senators that the customer emphasis will draw your attention but not result in a down grade. I am asking you to read the following analysis to decide if your view remains the same. Your input is crucial. The proposed legislation could become law within days. I am worried and concerned for the future financial security of Santee Cooper. Please share your thoughts. Sincerely, Guerry Green, Chairman of the Santee Cooper Board of Directors

> From: "Munson, Keith" <KMunson@wcsr.com>
 > Date: 2005/04/19 Tue PM 08:24:48 CDT
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 > <Jebrogdo@santeecooper.com>
 > Subject: Analysis of Impact of Senate 573

> Please see Confidentiality Notice before reading email.

> *****

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P.003

>
> Attached is my analysis of the impact of the provisions in Senate Bill 573. Feel free to share them with anyone.

>
> Lonnie: you might want to send to Wall Street since they have not had an opportunity to study the impact of the bill - this might give them a head start. If anyone does any analysis, I would appreciate a copy.

>
> Lonnie: Thank you for getting the video tape of the Senate debate from Yesterday (the 18th). Please have an extra copy made as I am sure I will want to take a copy with me after the meeting on Friday.

>
> Thanks, KEITH

>
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P.004



**WOMBLE
CARLYLE
SANDRIDGE
& RICE**

A PROFESSIONAL LIMITED
LIABILITY COMPANY

FROM: Keith D. Munson, Esq.

DATE: April 19, 2005

RE: Senate Bill 573 Summary of Legal/Practical Impact (H3732 is Companion Legislation in the S.C. House)

MEMORANDUM

GEORGIA
NORTH CAROLINA
SOUTH CAROLINA
VIRGINIA
WASHINGTON, DC

Section 1:

- Adds the Santee Cooper Board to the list of boards for which members may only be removed for cause.

- The last two governors replaced all or most of the board members of Santee Cooper, yet Santee Cooper has had continued growth and success over this period.
- A governor should control executive state agencies during the term of his administration (and not subsequent years);
- After a contested election, this could result in a Santee Cooper board that is openly hostile to the new governor to the detriment of South Carolina.
- Because of the unique and significant economic development role of Santee Cooper, it is important for the economic development philosophy of the board to be consistent with the sitting governor;

Section 1: (Cont'd)

- Also provides that a member of the Santee Cooper board may be removed for failing to appropriately discharge his duties (including the duty to act in the "best interests" of customers) and for a conflict of interest.

- Because "best interests" under Section 58-31-55 is slanted in favor of the customer/co-ops (over the interest of Santee Cooper), allowing a governor to remove for a violation of best interest, in practice, will mean that customer/cooperative groups will have a basis to press for the removal of board members who are intent on protecting the interests of all South Carolinians over the parochial interests of co-ops.

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Senate Bill 573 Memorandum (KDM)
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<p>Section 2: State employees who commit actual fraud, or crimes involving moral turpitude are outside the state's governmental immunity protection. This section would strip the Santee Cooper board members of state governmental immunity for more unintentional imprudent actions or indirect conflicts of interest.</p>	<ul style="list-style-type: none"> ▪ Santee Cooper board members would be the only state employees or state board members treated like criminals for mere simple negligence. ▪ This simple negligence could include a difference of opinion as to the "best interest" of Santee Cooper's customers, especially its largest customer, the electric cooperatives (since "best interest" is expressly defined to require favoritism over Santee Cooper). ▪ Although the provision purports to align the Santee Cooper board members with corporate directors, the addition of the "best interest" provision (which requires the board members to favor the co-ops and other customers over the interests of Santee Cooper) is unique and virtually makes any action by any board member questionable. ▪ This provision singles out the board members of the public service Authority as the only state employees or state board members not entitled to insurance protection through the State Budget & Control Board or the Insurance Reserve Fund for simple negligence.
<p>Section 5: Provides that:</p> <ul style="list-style-type: none"> ▪ 4 board members must have "substantial experience on an electric cooperative board"; ▪ 1 board member from large industrial customer; ▪ Those board members residing in the service territory counties must now be customers of Santee Cooper; ▪ Santee Cooper board members will be qualified by the state regulation of public utilities review committee.¹ 	<ul style="list-style-type: none"> ▪ No private corporation would allow its largest customer (co-ops) to hold over 35% of the seats on its board of directors. ▪ Requiring the Horry, Berkeley and Georgetown County board members to necessarily be customers of Santee Cooper, encourages an inherent conflict of interest and significantly reduces the pool of possible candidates.

¹ Section 4 merely authorizes the Public Utilities Review Committee to review candidates.

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Section 6: Modifies the powers of the Public ServiceAuthority in the following significant respects:

- The Authority may not dispose of significant property used in generation, transmission or distribution (not deemed surplus) without prior approval of the General Assembly.
- The Authority may not do any feasibility analysis of the sale transfer or other disposal of significant property (not deemed surplus) without prior approval of the General Assembly.

Section 7: Basically makes applicable the general corporate director duties to the Santee Cooper board of directors. However, it also expressly defines the best interest of the Public Service Authority to include a balance of only the following:

- (a) preserving financial integrity for the benefit of customers (including co-ops); and
- (b) economic development only in customer areas (including co-ops).

- Had this provision been in place in 2005, South Carolina would not have been able to land the \$100 million plus Gypsum/Drywall manufacturing facility recently announced for Georgetown County (which I believe is expected to be the second or third largest employer in Georgetown County).
- According to Santee Cooper management, in its 60 years of existence, there have been approximately 20 feasibility studies, which shows from a historical standpoint that they are useful and necessary to the general business operations of the Authority.
- Under S.C. Corporations Act (§33-8-300(a)(3)), fiduciary duties run solely to the corporation and its owners. Under S-573, the Senate would have fiduciary duties running solely to customers. No private business could be successful if it ignored the needs of the company and its employees and focused only on the wants of its most vocal customers.
- Economic development for the state at large would be a breach of duty.
- Could prevent application of the §58-31-120, which requires Santee Cooper to use South Carolina Workers and South Carolina Contractors whenever possible.
- Any capital project with a useful life beyond the co-ops existing contract could be a breach of this duty.
- Inherent conflicts between the interests of retail customers, industrial customers and wholesale customers (the co-ops) could make any decision a breach of duty from different perspectives.

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<p>Section 7: (Cont'd) Also makes the corporate conflict of interest statutory provisions applicable to the board of directors of Santee Cooper. Generally, under the corporate code, a conflict of interest can be cured if the transaction was "fair" to the company. In the proposed legislation, this provision has been modified to require that the transaction be "<u>fair</u>" to <u>both</u> the Public Service Authority <u>and</u> its customers.</p>	<ul style="list-style-type: none"> ▪ By requiring that any transaction be "fair" to <u>both</u> the Authority and all its customers, this traditional method of curing a conflict of interest is basically unavailable. Consequently, the only way to cure a conflict of interest is by a ratification of the board (which the board may be reluctant to do for fear that such an act would be misconstrued as a breach of the best interest of the customers and result in individual lawsuits) (see below).
<p>Section 7: (Cont'd) The proposed legislation provides for individual liability against any and all member(s) of Santee Cooper on the following terms:</p> <ol style="list-style-type: none"> 1) Private cause of action granted to any customer, any coop, and any customer of any coop; 2) For breach of any duty, including a difference of opinion as to the "best interest" of Santee Cooper's customers, or a remote indirect conflict of interest; 3) No proof of damages required; 4) Plaintiff (but not board member) is entitled to attorney's fees if successful; 5) Customers could obtain statutory damages of up to \$50,000 in aggregate per occurrence. 	<ul style="list-style-type: none"> ▪ This is the polar opposite of tort reform. • No consequence for frivolous action. ▪ No damages or other harm need be shown by plaintiff (this encourages opportunistic and nuisance lawsuits). ▪ Allowing courts to grant "appropriate equitable relief" encourages endless ongoing court supervision of the operations of Santee Cooper. ▪ These causes of action would be in <u>addition</u> to <u>any</u> common law or other existing causes of action that already exist.
<p>Section 8: The proposed legislation modifies the traditional payment to the state formula to require that the payment must be in the "best interests" as defined above. However, there is a safe harbor provision allowing the Santee Cooper Board to pay to the State up to 1% of revenues.</p>	<ul style="list-style-type: none"> ▪ As noted, best interest of the Authority is expressly defined to be the best interest of the <u>customers</u> of the Authority. Consequently, any payment to the State General Fund or State Treasurer (beyond the 1% safe harbor amount) would necessarily conflict with the "best interest" as herein defined because their benefit would reach beyond the customers of Santee Cooper (to the general benefit of the taxpayers of the state).

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As drafted, I believe a number of the existing members of the Santee Cooper board of directors would feel compelled to resign. In addition, it would be difficult to replace those board members with similar board members. For example, it is very unlikely that a large law firm or a large industrial customer would allow one of its partners or senior executives to expose themselves and their company to the potential liability and hassle from the potentially endless strike suits created and encouraged in this legislation.

There can be little doubt that the practical effect of this legislation would be to surrender control of Santee Cooper to its customers. To the extent the customers have inherent differences and therefore cannot agree on how to manipulate Santee Cooper to their advantage, it could surrender Santee Cooper to chaos or continuous court supervision.

It has previously been reported that "Wall Street" and some of the rating agencies have expressed concern about the prior proposed legislation that merely loaded the board with cooperative representatives. This proposed legislation would probably cause Wall Street to panic.

Finally, it is questionable whether Santee Cooper could even buy commercially available director and officer liability insurance for members of the board of directors of Santee Cooper under this legislation. Certainly, Santee Cooper would have to maintain a deductible so high that it would have to pay each \$50,000 judgment. Ironically, the result then would be that opportunistic individual customers would race to the courthouse (because there is only one recovery per occurrence), file suit, take their personal settlement and Santee Cooper would charge it back against the rest of the customers as a cost reflected in their rates! That right -- it's another LOTTERY!

KDM

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The McGraw-Hill Companies

**STANDARD
& POOR'S**Corporate & Government Ratings
55 Water Street
New York, New York 10041-0003
212-438-7916 Tel
212-438-2154 Fax**Fax***Couch*
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Attention	From <i>Dimitri Nikas</i>
Company	Date <i>5/16/2005</i>
Fax Number	Total Number of Pages, Including Cover

STANDARD
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RATINGS DIRECT

Research:

Return to Regular Format

Summary: South Carolina Pub Svc Auth; Utility, CP; Utility, Wholesale Electric

Publication date: 03-May-2005
 Primary Credit Analyst(s): Dimitri Nikas, New York (1) 212-438-7807; dimitri_nikas@standardandpoors.com
 Secondary Credit Analyst(s): David Bodek, New York (1) 212-438-7969; david_bodek@standardandpoors.com

Credit Profile**AFFIRMED**

\$2.089,964 bil. South Carolina Pub Svc Auth	AA-
\$197.720 mil. South Carolina Pub Svc Auth (FSA)	AAA/AA-(SPUR)
\$30.455 mil. South Carolina Pub Svc Auth prior oblig	AAA
\$587.749 mil. South Carolina Pub Svc Auth rev oblig (AMBAC)	AAA/AA-(SPUR)
\$123.000 mil. South Carolina Pub Svc Auth rev oblig (Taxable)	AAA/AA-(SPUR)
\$281.140 mil. South Carolina Pub Svc Auth rev oblig 2002 tax-exempt ser B due 01/01/2009-2010 2012-2019 2032 2033 2036 2037	AAA/AA-(SPUR)
\$91.775 mil. South Carolina Pub Svc Auth rev oblig 2002 taxable ser C due 01/01/2005-2008	AAA/AA-(SPUR)
\$374.125 mil. South Carolina Pub Svc Auth rev oblig rfdg bnds ser 2002 D dtd 10/22/2002 due 01/01/2008-2021	AAA/AA-(SPUR)
\$108.035 mil. South Carolina Pub Svc Auth rev oblig rfdg ser 2002 A dtd 04/03/2002 due 01/01/2005-2021	AAA/AA-(SPUR)
\$197.000 mil. South Carolina Pub Svc Auth rev oblig tax-exempt	AAA/AA-(SPUR)
\$214.555 mil. South Carolina Pub Svc Auth rev rfdg bnds ser 1997 A dtd 08/01/1997 due 01/01/1998-2000 2004 2005 2009-2013 2017 2019 2027 2032	AAA/AA-(SPUR)
\$26.815 mil. South Carolina Pub Svc Auth rev rfdg bnds ser 1998 B dtd 09/01/1998 due 01/01/1999-2011 2013 2018 2025	AAA/AA-(SPUR)

OUTLOOK:

NEGATIVE

AFFIRMED

\$250.000 mil. South Carolina Pub Svc Auth comm ppr prog	A-1+
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OUTLOOK:

NEGATIVE

Rationale

Standard & Poor's Ratings Services affirmed its 'AA-' ratings on the South Carolina Public Service Authority's (Santee Cooper) bonds and revised the outlook to negative from stable. The outlook revision reflects Standard & Poor's concerns emanating from the likely passage of pending legislation, which would alter the makeup of Santee Cooper's board of directors, providing four seats to directors whose interests would likely be aligned with Santee Cooper's electric cooperative customers and one seat to a director whose interests would be aligned with Santee Cooper's large industrial customers.

Standard & Poor's is concerned that a move from today's board composition, which consists of a more independent representation from each of the state's congressional districts, to a board comprised of stakeholders with interests that may be adverse to Santee Cooper's interests—particularly in the area of ratemaking and associated financial performance—could permit these parties to advance their interests to the detriment of Santee Cooper's financial profile. These concerns become even more significant in the current environment of increasing fuel costs as well as in light of Santee Cooper's need to add debt to finance the construction of more than 1,000 MW of generation capacity additions and other projects

over the next few years. At the same time, the pending legislation includes items that could provide support to credit quality, including a ceiling on annual contributions to the state. Other provisions of the proposed legislation are, on balance, neutral to credit quality.

The ratings on Santee Cooper reflect the following strengths:

- A strong competitive position characterized by substantial coal-fired generation (53% of total capacity; 75% of total energy) that provides for competitive wholesale rates to customers and a lack of restructuring efforts, mitigating competitive pressures.
- Long-term contracts with wholesale and industrial customers that provide considerable stability to revenues and cash flow.
- Ability to recover fuel and demand charges dynamically, which allay price and commodity risk.
- A large, growing, and diverse customer base covering most of the state of South Carolina and encompassing some of the fastest-growing areas, especially along the coastline, that has demonstrated growth in excess of 2.0% annually over the past few years.
- Management's proactive efforts to prudently and efficiently increase and diversify owned generation capacity while maintaining adequate reserve margins.

These strengths are offset by the following challenges:

- The likely passage of proposed legislation that would alter the makeup of Santee Cooper's board through representation of cooperative and industrial customer interests and could potentially influence Santee Cooper's rates to the detriment of the utility's financial profile.
- Despite efforts to diversify generation resources, Santee Cooper's significant and continued reliance on coal-fired generation is expected to lead to modestly higher average wholesale rates over the short term, reflecting the effect of increased coal prices. Although the authority is able to recover all fuel-related cost variations, thereby preserving the strong levels of debt service coverage, there is some concern about the effect of protracted high electricity prices on the authority's industrial customers, the top 10 of which contribute about 23% of total revenues.
- The financing resolution describing the revenue obligations has relatively flexible legal covenants, including no additional bonds test and no debt service reserve requirements. However, the utility's two senior obligations have closed liens and all new money must be issued under the revenue obligation resolution.
- A measure of customer concentration and industrial exposure (26% of revenues, 32% of sales).

Santee Cooper has a strong business position of '3' (business profiles are categorized from '1' (strong) to '10' (weak)), reflecting the implicit regulatory support, fast growing markets, efficient operations, strong competitive position, and proactive management. The strong business position is complemented by solid financial profile with adequate debt service coverage, strong liquidity, financial flexibility to meet working capital needs, and disciplined growth strategies that do not adversely affect financial performance.

In an effort to address consistently growing demand, Santee Cooper is expanding the existing two-unit Cross generating station by 580 MW to be completed in 2007, and a further 580 MW to be completed in 2009. The recent increase in coal prices provides some concern, as it may lead to modestly higher average wholesale rates over the short term, reflecting Santee Cooper's material reliance on coal-fired generation. An additional concern is that coal supplies on hand are down to about 30 days from their historical average of about 45 days, in part reflecting the effect of transportation challenges by local carriers as well as the increased demand for coal in an environment of declining production. Santee Cooper expects that supplies on hand will reach about 40 days by year-end 2005. Santee Cooper procures coal supplies on its own and relies on The Energy Authority to procure the necessary gas supplies for the gas-fired Rainey station.

The current revenue obligation resolution requires no financial test for parity debt and places greater emphasis on management's continuation of its disciplined financial policy to maintain strong financial ratios in order to avoid a severe dilution of debt coverage. While no debt service reserves are required under the revenue obligation resolution, the existing debt service reserves of six months of accrued interest will be maintained on the outstanding revenue bond obligations. Also, the capital improvement fund is replenished annually to a funding level averaging 8% of revenues during the past three fiscal years.

The utility's financial profile remains strong and is characterized by funds from operations coverage of debt service of 1.95x in 2004. Equity to assets has remained adequate at about 26%, while short-term debt to total debt is modest at about 6.4%. Even though total debt, including current maturities and commercial paper (CP), has increased to about \$3.038 billion at year-end 2004, debt per kilowatt of owned capacity continues to remain modest at about \$669 but has increased from \$620 in 2003.

Short-term credit factors

Santee Cooper's short-term rating is 'A-1+', largely based on the authority's debt rating and reflecting a strong financial profile combined with adequate liquidity, the ability to fund internally a material portion of ongoing capital spending, and the expectation that the electric operations will continue to generate stable cash flow, in part aided by the ability to recover power cost variations in rates without lag. The security for the CP is provided by the authority's net revenues and is subordinate to the original bonds, revenue bonds, revenue obligations, and any lease payments.

Liquidity is adequate with 71 days of cash on hand (excluding availability under the CP program) during 2004. When combined with the authorized \$450 million CP program, liquidity should be sufficient to meet upcoming debt maturities and capital spending needs. While Santee Cooper is authorized to issue up to \$500 million in CP, the authority has covenants to issue only up to \$450 million and consequently has a \$450 million credit facility to provide liquidity. The credit facility is for three years and matures in October 2007.

Debt service for 2004 was about \$240 million before rising to about \$300 million by 2007 and remaining flat after that. Financial management is conservative as demonstrated by the utility's ability to manage capital expenditures while at the same time maintaining a very stable financial profile.

■ Outlook

The negative outlook on Santee Cooper reflects concerns emanating from the likely passage of legislation that would alter the makeup of Santee Cooper's board of directors, providing four seats to directors with cooperative experience and one seat to a director with large customer experience. Under such a board structure, the concern centers on the potential for Santee Cooper ratepayers to influence rates and, in turn, financial metrics, to advance their interests to the detriment of Santee Cooper's financial profile. Should this scenario materialize, the ratings could be lowered. However, the outlook could be revised to stable if the new board demonstrates that it will act in the best interests of Santee Cooper, preserving the utility's strong business and financial profiles.

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

From: "Richard Coen" <rcoen@coencapital.com>
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 Sent: Monday, March 14, 2005 3:19 PM
 Subject: San Diego-Tuesday Dinner

Fellow Board Members,

We had a wonderful dinner at Greystone Steak House with several members of the co-ops. After dinner we were walking home and ran into Paul Nuehedel. He works for JP Morgan and interestingly enough they were one of the participants in the Santee Cooper RFP by the governors office. Paul was with Alan Spen with Fitch Ratings. Lonnie told me that Alan was one of the principals that issued the potential "downgrading" for Santee Cooper. We had a long conversation regarding that rating and that opinion. In retrospect, it was probably fair given the circumstances and uncertainties from the investors perspective and based on the information that they had. However, I asked Alan to please contact management and members of the Board of Directors, primarily the chairman, before they issue any more opinions. I expressed confidence that Santee Cooper's Bond Ratings should stay positive given the recent refunding as a result of managements good efforts. Alan offered that the ratings and opinions have little to do with bond refunding. I told him that we feel the ratings are the basis for public opinion and formulate the investors opinion of value and risk regardless of whether it is a refunding or a new issue. Perception is reality in the financial world and any opinion of possible, potential or actual down ratings effects Santee Cooper. We had very good conversations and it is clear that Fitch Ratings knew exactly what they were doing and those were turbulent times. Hopefully, Fitch will take another look at Santee Cooper, it's current Board of Directors, it's current management and their agenda and issue a more positive opinion for the future of Santee Cooper to the investment community.

I explained to Alan that the main purpose for our traveling to San Diego was to engage the electric cooperatives and try and rebuild the relationships had been lost as a result of misinformation, uncertainty and confusion. I also tried to express that the governor's decision to remove the past chairman was in no way political but rather a response to requests by a majority of the board members in an effort to build consensus and improve Santee Cooper. I was not critical of individuals or policies of the past however, I was clear on my optimism under the new regime. The diversity of our board and respect that we have for each other's backgrounds, experience and integrity will be good for Santee Cooper as we move forward.

I hope that the coops feel that we have made some significant progress. If you have a chance please call Alan Spen at Fitch Ratings and discuss your opinion of the current state of affairs with him. They base their opinions on what they hear and responses to questions that they have. One interesting fact is that one of Alan's partners that was walking on the sidewalk mentioned to Paul (JP Morgan) that he knew exactly what he was doing when he issued the last opinion. Clearly they were aware of the implications of their opinion and how it could be used against the current Board and Santee Cooper. They owe us another look and a fresh opinion based on the current facts. It is unfortunate that they did not consult Lonnie or any of the Board members prior to the last opinion. Our relationship with Wall Street is critical and it will either be used for us or against us as we move forward. They are searching for information and answers and the Board and management should communicate openly to promote Santee Cooper for the benefit for the state and our customers.

We enjoyed seeing everyone and look forward to seeing you at the next Board meeting.

Regards,
 RHC

RATING PROCESS